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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 Rate Regulation	)))))))	MM Docket No. 92-266

JOINT OPPOSITION TO PETITIONS FOR RECONSIDERATION

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To: The Commission

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PETITIONS FOR RECONSIDERATION

I. INTRODUCTION & SUMMARY

The Parties listed in Attachment A,[1/] pursuant to Section 1.429 of the Commissions rules, hereby oppose certain petitions for reconsideration of the rate regulation rules adopted by the Commission in this proceeding. Several parties have argued that the Commission should further reduce cable operator revenues through alterations of existing benchmark calculations, limitations on pass through of external costs, and narrowing the definition of "effective competition". This Joint Opposition is being filed because of our belief that neither the Commission nor

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1/ The parties listed in Attachment A are primarily operators of smaller cable systems who will be hit hardest by the Commission's current approach to rate regulation.

those advocates of more stringent regulation comprehend the detrimental impact of the rate regulation scheme on the cable industry, franchise authorities, and cable subscribers.

The Commission's complex and extreme rate regulation will wreak financial havoc on the cable industry and will not

1. Revise the benchmarks to more accurately reflect the reality of the cable television business;

2. Permit additions to those revised benchmarks to reflect extraordinary expense categories of many cable operators;

3. Reduce burdens of rate regulation on small cable systems and franchising authorities;

4. Revise the regulation of equipment charges; and

5. Make a number of practical and procedural changes in the regulations to alleviate some of the unnecessary adverse consequences.

It is critical also that the Commission establish a transition period with interim rules, which would provide for some orderly transition for the cable industry from a diverse, unregulated environment to a regulated industry. Finally, we urge the Commission to act in this proceeding on an expedited basis, and to clarify many of the unresolved questions regarding the current rate regulations before they become effective.

II. THE CURRENT BENCHMARKS ARE UNREALISTIC FOR MANY CABLE SYSTEMS AND MUST BE REVISED

In seeking reconsideration, King County, et al. ("King County") asked the Commission to reduce benchmark rates further and to permit franchising authorities to initiate cost-of-service proceedings. These requests ignore the basic flaws in the current regime.

The putative objective to the FCC's dual benchmark/-cost-of-service election scheme was to set benchmarks at a level at which most cable operators could continue to run their businesses, presumably at a reasonable profit as provided under the 1992 Cable Act. If a cable operator's costs require rates that are above the benchmarks, the cable operator can opt for rate justification through a cost-of- service proceeding. Unfortunately, the current benchmarks are unrealistic for many cable systems. The benchmarks should be revised so that cable operators will utilize them as initially intended, rather than forcing the FCC, franchising authorities, and cable operators into complex and burdensome cost-of- service rate proceedings.

In this proceeding there have been a number of filings by financial institutions and others demonstrating that lending has dried up based on the banks' assessment that the current rate regulations will drive many cable systems into default on outstanding loans and financial obligations. The current benchmarks will have a devastating impact (as much as 25% to 35%) on cable operators' cash flow, upon which the cable industry has traditionally relied to pay down interest, attract investment, add services, and rebuild facilities.

A. The Benchmark Rates Are Too Low Because They Are Based On Flawed Data and Invalid Assumptions

The Commission has used flawed data and made erroneous assumptions in setting the benchmark rates.[2/] The data does not account for the type of stable marketplace competition required for making reasonable benchmark determinations. The data used by the FCC does not reflect marketplace realities, or even situations where true "effective competition" exists. Moreover, the Commission's approach takes the average of the rates in the survey and uses that average as the maximum permissible rate. In addition, the benchmark rates are contrary to the 1992 Cable Act because they fail to take into account the cost of providing service[3/] and do not provide for a reasonable profit.

2/ The Commission already has acknowledged that certain survey data used to devise benchmark rates contained errors, but the Commission has declined to use data provided by NCTA to correct certain of those errors. The Commission should not use flawed data as the basis for regulation which has such a far reaching and profound impact.

3/ See, James N. Dertouzos and Stephen F. Wildman, Regulatory Benchmarks For Cable Rates; The FCC Methodology (attached to Petition For Reconsideration and Clarification of VIACOM International, Inc.).

The only cost variables reflected by the benchmarks are the number of cable subscribers and the number of cable and satellite cable channels on a system. Other equally significant variables are ignored, such as subscriber density, programming and equipment discounts, and extraordinary cost categories applicable to many cable operators. The benchmarks ignore these cost distinctions and simply tar cable operators of all sizes and characteristics with the same brush, ignoring marketplace and economic realities. The Commission's failure to take into account cost differentials makes the benchmark rates arbitrary and unusable for many cable operators.

B. The Benchmarks Should Not Reflect

universal service required by the franchise. In another variation, rates are skewed where the overbuilder resorts to benchmark rates is in direct violation of the Cable Act. 47 U.S.C. § 623(b)(2)(C).

D. The Commission Should Provide An Extraordinary Expense Category As An Addition To Benchmarks

Several commenters argue that the Commission should limit the types of costs that cable operators may pass through to customers. On the contrary, the Commission should permit specific additions to the benchmarks for extraordinary expense categories. Examples of such extraordinary expense categories include additions for rural and other systems with low population density or low penetration, systems with extraordinarily high microwave costs, and systems with extraordinarily high compulsory copyright fees (i.e., those subject to the 3.75% copyright rate). In addition, systems which are required to have underground construction, the cost of which can be 3-4 times greater than aerial construction, should be accounted for in the benchmark approach. Storm damage, and other catastrophic losses not covered by insurance should be added, as should unusually high bad debt expense or property tax rates which are faced by some cable operators. To determine extraordinary expenses, the expense category. Such additions to the benchmarks will permit many more cable opoerators to use benchmarks, rather than cost-of-service rate justifications.

E. Capital Costs For System Upgrades Should Be Treated As External Costs Under The Price Caps

Some parties in this proceeding have advocated requiring cost-of-service cases to justify rates needed to recover the costs of a system upgrade. Capital costs for system upgrades should be treated as external costs under the price caps. Otherwise, cable operators will be prevented from upgrading and expanding systems, a result directly contrary to congressional intent. Because benchmarks are based on a static analysis, they fail to recognize on-going changes in the operational costs of a system over time. In order to allow for these going-forward changes, the FCC has set up several categories of expenses or external costs that cable operators may automatically pass through to subscribers once initial rates have been set relative to the benchmark. It is essential that the Commission retain and expand this "pass-through" policy to include improvements in cable systems' operations and development of new broadband communication services.

Faced with competitive pressures and given no realistic alternative, cable operators would be required to file cost-of-service cases whenever they seek to upgrade their systems, causing a flood of cases on an already overloaded regulatory mechanism. Imposition of cost-of-service proceedings on cable operators at every turn will effectively prevent the cable industry from responding effectively to the rapidly changing communications marketplace. Cost-of-service proceedings also will give unregulated competitors the ability to manipulate and delay cost-of-service proceedings in the hope of gaining tactical advantage. Accordingly, system rebuilds and improvements must be treated as external costs under the price caps.

E. Cable Operators Should Be Permitted To Use identical throughout a system. The Commission, however, has created a major and needless obstacle by requiring that franchise fees be uniform within all communities in order for a cable operator to calculate rates on a system-wide basis. This approach simply makes no sense. Franchise fees are external to rate calculation. If a system's rates (without consideration of the franchise fee) are constant throughout the communities served, there simply is no reason to limit the use of system-wide calculations.

Moreover, requiring prior franchising authority approval of system-wide rate treatment for systems with identical rate characteristics, does not serve the public interest and will increase administrative burdens. Local officials should not be empowered to force the production of community specific worksheet computations where the operator is offering the same channel lineup, and charging the same service and equipment rates to all communities served.

Finally, the Commission should not require the incluservices, including cable service, are typically stated without including taxes. There is no reason to believe that Congress meant to prohibit cable television operators from utilizing this generally accepted marketing practice, particularly when it will avoid subscriber confusion.

G. Cable Operators Must Be Permitted To Alternate Between Benchmarks And Cost Of Service Justifications For Both Basic and Satellite Tier Rates

A cable operator must be allowed the option of alternating between benchmarks and cost-of-service justifications for basic and satellite tier rate regulation. Requests for the FCC to declare that a cable operator is straightjacketed by one

Furthermore, Section 623 of the 1992 Cable Act precludes a single method of justification for basic and tier rates. The statute requires different standards and procedures for regulations governing basic and tier rates, and mandates a different forum for the regulation of each tier. Accordingly, the Commission should clarify that a cable operator may choose cost-of-service justification for one tier and the benchmark approach for the other.

III. THE COMMISSION'S RULES REGULATING EQUIPMENT, INSTALLATION AND ADDITIONAL OUTLET CHARGES SHOULD BE REVISED

Contrary to the assertions of several parties in this proceeding, the Commission's newly-adopted rules regulating equipment charges are based on an overly-broad interpretation of the 1992 Cable Act. The scope of these regulations should be limited to avoid the unintended consequence of increasing monthly rates for the majority of cable subscribers. At a minimum, in order to avoid the sudden impact of these rate changes on subscribers, the Commission should establish a transition period of 5-7 years for implementing equipment regulations and the revenue neutral rate adjustments necessary under the regulation of equipment charges.

Section 623(b)(3) of the 1992 Cable Act directed the Commission to prescribe rate regulations for equipment "used by subscribers to receive the basic service tier." 47 U.S.C. §543(b)(3). In its Report and Order, the Commission adopted an expansive interpretation of this section by determining that any equipment that could be used in connection with basic service is subject to actual cost regulation. Since most equipment necessary to receive cable programming services conceivably could be used in connection with basic service, virtually all equipment will be subject to cost-based regulation. A much more reasonable it. As charges for equipment and additional outlets are reduced, cable operators must make the necessary revenue-neutral adjustments in the monthly service rates of all subscribers. For example, the monthly charges for a wealthy subscriber who has several outlets and converters will go down, while the monthly charges for subscribers with only one outlet will go up. This anomolous result was never intended by Congress and will infuriate millions of subscribers who are expecting rate reductions but instead will receive rate increases.

IV. THE COMMISSION SHOULD COMPLETE ITS COST-OF-SERVICE RULE MAKING BEFORE REQUIRING CABLE OPERATORS TO ELECT BETWEEN RATE REGULATION APPROACHES

In addition to being grossly unfair, requiring cable operators to choose between two methods of rate regulation when one of those methods has not yet been defined, violates substantive due process. The 1992 Cable Act and its myriad implementing regulations have presented cable operators with a mammoth task: implementing mandatory changes to virtually every business practice of an entire industry, in six months or less. Due to the complexity and uncertainty of the rate regulation rules adopted thus far, the rate regulation aspects of the 1992 Act have presented cable operators with especially onerous implementation burdens.

The Commission claims that cable operators have a choice between benchmark rates or cost-of- service justifications, but that is not a real choice. Many operators cannot afford the complicated and burdensome cost-of-service proceedings. For those who dare, the Commission has warned that cost-of-service cases are not a safety net -- rates may be set at any level deemed "reasonable" by the regulators. Franchising authorities are free to prescribe any rate for basic service that is "rational". The risks of such a cost-of-service approach are untenable for many operators.

The cable industry as a whole has launched into preparing detailed analyses on how the benchmark approach to rate regulation will affect each system. Many operators have completed these anaylses. However, because the Commission only now has begun its cost-of-service rule making, most cable operators are not in a position to determine the type of regulatory approach they should elect. The Commission must provide cable operators sufficient advance notice to elect between benchmark and cost-of-service to evaluate thoroughly the cost-of-service standards. In addition to having sufficient time to make a thorough and well-reasoned rate election decision, cable operators require a minimum of 45-60 days to adjust their billing notices to reflect these changes.

V. THE BURDENS OF RATE REGULATION ON SMALL SYSTEMS AND FRANCHISING AUTHORITIES MUST BE REDUCED

Section 623(i) of the 1992 Cable Act recognized that cable operators with 1,000 or fewer subscribers should be subject only to streamlined rate regulation. Specifically, Congress provided that:

> In developing and prescribing regulations pursuant to this section, the Commission shall design such regulations to reduce the administrative burdens and cost of compliance for cable systems that have 1,000 or fewer subscribers.

47 U.S.C. § 543(i). Despite this explicit instruction, the Commission has made no serious attempt to adopt regulations that would account for the special burdens on the small system. Furthermore, this administrative burden falls heavily on franchising authorities in smaller communities which do not have the staff, the resources or the desire to hire consultants, lawyers and accountants to regulate cable systems under the current complex scheme.

Small cable systems have fewer subscribers, staff and resources. Moreover, small operators have much higher costs for programming, equipment and most other aspects of their operation. However, the Commission's rate regulation rules, as adopted, require the same complex, time-consuming Form 393 analyses to be prepared, regardless of the size of the system. The proportionate effect that these administrative and financial burdens place on smaller systems' resources is enormous. Currently, the Commission's rules do not adequately reduce the burden of compliance on small systems or on franchising authorities.

Despite the arguments of some petitioners in this proceeding that rate regulation is needed regardless of size, the Commission should exempt small systems entirely from this complex rate regulation process. Congress did not prohibit such an exemption. Furthermore, the exemption would be consistent with other FCC regulations with exemptions for small operators, such as the Commission's network programming non-duplication rules (47 C.F.R. §76.95(a)), the syndicated exclusivity rules (47 C.F.R. §76.156(b)) and the public file requirements (47 C.F.R. §76.305(a)).

At a minimum, the Commission should provide a highly streamlined rate review process for small system operators. For example, systems with fewer than 1,000 subscribers should not be required to file Form 393 or other complex forms and rate cases. A straightforward exemption based on a prescribed range of profit, revenue level, or small-system national average should be implemented.

Calculation of subscribers to determine the size of a system should be made on a "per community," as opposed to a "per headend" basis. This approach is consistent with the Commission's overall rate regulation procedures which are applied on a community-by-community basis. Any small cable system definition should be determined in the same manner since the same procedures and level of paperwork are required for each community.

Furthermore, the exemption should be granted based on the number of subscribers to the cable system, regardless of whether the operator owns only one, or more than one cable system. Such differences should be irrelevant since the financial and administrative difficulties are comparable for each small system.

VI. FRANCHISING AUTHORITIES MAY NOT ESTABLISH THE NUMBER OF CHANNELS ON A BASIC SERVICE TIER

Certain petitioners, such as NATOA, argue that the Cable Act grants local franchising authorities the power to dictate the number of channels that should be on the basic service tier. This vastly overstates the authority granted to local franchising authorities under the Cable Act, and raises serious implications. First, such authority would allow franchising authorities to require so many basic channels that they will, in effect, control the rates of all satellite-delivered programming services. In the same vein, the local authorities essentially would have the power to control retiering. The effect of this control over channels, which effectively translates into control over rates, would nullify Section 623's mandate that cable programming service rates be regulated at the FCC.

VII. THE COMMISSION MUST MAINTAIN POLITICAL ACCOUNTABILITY FOR COSTS IMPOSED BY FRANCHISE

Several of the municipal commenters ask the Commission to reconsider its decision to provide for political accountability by allowing direct pass-through of PEG costs to subscribers and by allowing for line itemization. Because the costs associated with franchise requirements are substantial, cable operators should not be required to take the political heat for costs that they do not control.

Franchising authorities directly control significant costs of cable service that must be recovered from subscribers. Municipalities argue that cable operators control franchise fees and other "voluntary" franchise requirements. These arguments are meritless as existing franchise commitments are contractual in nature and the cable operator would be charged with default if it failed to meet its franchise obligations that require it to incur costs in the future. Similarly, franchise provisions negotiated as a part of a franchise renewal cannot be deemed "voluntary" because they often are the product of adversarial negotiations, with the franchising authority making demands on the cable operator.

VIII. THE COMMISSION'S RATE REGULATIONS RAISE FUNDAMENTAL CONSTITUTIONAL ISSUES

The rate regulations adopted by the Commission violate the Speech and Press Clause of the First Amendment, which provides that "Congress shall make no law ... abridging the freedom of speech, or of the press." The Supreme Court recently observed that a cable television operator "provides to its subscribers news, information and entertainment" and "is engaged in 'speech' under the First Amendment, and is, in much of its operation, part of the 'press'." Leathers v. Medlock, 111 S. Ct. 1438, 1442 (1992). The Commission's rate structure violates cable operators' First Amendment rights in at least two obvious ways.

First, the danger presented by the benchmark formula is analogous to, but more severe than, that considered in Leathers, where the Supreme Court explained that the risk created by selective taxation of the press "is similar to that from content-based regulation: it will distort the market for ideas." Leathers, 111 S. Ct. at 1445. When a cable operator is compelled to consider foregoing certain programming additions or modifications because it is unclear whether the costs of that service will be sufficiently recovered by the regulated rate, the marketplace for ideas is skewed. Second, the unrestrained discretion delegated to local authorities to rule on cost of service showings, confers upon government the power (1) directly to punish the press for the publication of ideas and material deemed "offensive", and (2) indirectly to suppress potentially critical comment through less-than-subtle economic pressures. In either case, the government's ability selectively to control the "business" aspects of the communications media, and thereby to stifle comment, pose a constitutionally impermissible threat to the independence of a free press. See, e.g., National Treasury Employees Union v. United States, 990 F2d 1271, 1273 (D.C. Cir. 1993), (recognizing the content-based "potential ... for subtle pressure" created by speech-restrictive regulations). Here, of course, rate regulation has all of the subtlety of a sledge-hammer. There is no "better" way for public officials to keep the press "in line" than selectively to oversee the economic aspects of the business. See City of Lakewood v. Plain Dealer Pub. Co., 486 U.S. 750, 757-759 (1988).

The Commission's rate regulations also violate the Takings Clause of the Fifth Amendment. The benchmark method prohibits many cable operators from recovering the costs of providing service and severely interferes with their ability to continue to attract capital. The cost-of-service option does not salvage the rate structure.

As early as 1922, Justice Holmes stated that "while property may be regulated to a certain extent, if regulation goes